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BEFORE THE ARIZONA CORPORATION COMMISSION

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KRISTIN K. MAYES - Chairman

GARY PIERCE

PAUL NEWMAN

SANDRA D. KENNEDY

BOB STUMP


IN THE MATTER OF THE APPLICATION OF
SUNRISE WATER COMPANY FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PROPERTY AND
FOR AN INCREASE IN ITS WATER RATES
AND CHARGES.

DOCKET NO. W-02069A-08-0406

**STAFF'S NOTICE OF FILING
SUPPLEMENTAL TESTIMONY**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Supplemental
Testimony of Staff Witness Alexander I. Igwe in the above-referenced matter.

RESPECTFULLY SUBMITTED this 22nd day of June, 2009.


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SUPPLEMENTAL

TESTIMONY

OF

ALEXANDER I. IGWE

DOCKET NO. W-02069A-08-0406

**IN THE MATTER OF THE APPLICATION OF
SUNRISE WATER COMPANY AN ARIZONA
CORPORATION FOR A DETERMINATION OF THE
CURRENT FAIR VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS RATES
AND CHARGES BASED THEREON FOR UTILITY SERVICE**

JUNE 22, 2009

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES

Chairman

GARY PIERCE

Commissioner

PAUL NEWMAN

Commissioner

SANDRA D. KENNEDY

Commissioner

BOB STUMP

Commissioner

IN THE MATTER OF THE APPLICATION OF)
SUNRISE WATER CO., AN ARIZONA)
CORPORATION, FOR A DETERMINATION)
OF THE CURRENT FAIR VALUE OF ITS)
UTILITY PLANT AND PROPERTY AND FOR)
INCREASES IN ITS RATES AND CHARGES)
BASED THEREON FOR UTILITY SERVICE)
_____)

DOCKET NO. W-02069A-08-0406

SUPPLEMENTAL

TESTIMONY

OF

ALEXANDER IBHADE IGWE, CPA

EXECUTIVE CONSULTANT III

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JUNE 22, 2009

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**EXECUTIVE SUMMARY
SUNRISE WATER COMPANY
DOCKET NO. W-02069A-08-0406**

This supplemental testimony provides Staff's response to Sunrise Water Company's ("Sunrise" or "Company") late exhibits, which suggest that the Arizona Corporation Commission ("Commission") allows Limited Liability Companies ("LLC") recovery of income tax expense; and by inference, other pass-through entities. Staff's analysis indicates that while the Commission may have inadvertently granted recovery of income tax expense for Fisher's Landing Water and Sewer Works, LLC ("Fisher") and Winchester Water Company, LLC ("Winchester"), these oversights have been corrected in each utility's subsequent rate filings. In the case of Wickenburg Ranch Water Company, LLC, it was an application for a new Certificate of Convenience & Necessity ("CC&N"), which is not subject to the level of scrutiny accorded a rate filing. However, Staff finds that there is the need to correct this omission as soon as practicable. Based on the above findings, the Company's conclusion from its cited cases is not supported by subsequent filings by Fisher and Winchester; and the corresponding recommendations by Staff.

As to the core issue of Commission policy on allowance of income tax recovery for pass-through entities, such as a LLC, or a Subchapter S corporation ("S-Corp."), or a sole proprietorship; Staff found Decision No. 60105 to be instructive. In the case of Camp Verde Water Systems, Inc, the Commission explicitly stated its policy as follows:

"The Company did not request any income taxes since it is a Subchapter S corporation and the Commission has adopted a policy of not allowing income taxes for entity which are not required to pay income taxes."

Based on the above quote from Decision No. 60105, there is no ambiguity or misunderstanding that the Commission does not allow recovery of income tax expense for LLCs, S-Corps and Sole Proprietorships. Further, Decision No. 60105 demonstrates that the Commission could exercise its discretion by granting exception to its policy, when public interest is better served by such decision. However, it appears that the Commission exercises its discretion based on the facts and circumstances surrounding each rate filing. There is no extraordinary circumstance that would warrant deviation from Commission policy in this instant case.

In conclusion, Staff finds that its recommendation to deny Sunrise's request for recovery of income tax expense, is appropriate and consistent with Commission policy.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Alexander Ibhade Igwe. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Are you the same Alexander Ibhade Igwe that has provided oral and written testimonies in this proceeding?

A. Yes.

PURPOSE OF TESTIMONY

Q. Why is Staff filing supplemental testimony in this proceeding?

A. During the administrative hearing in this proceeding on May 12, 2009, the Administrative Law Judge ("ALJ") granted the Utilities Division Staff's ("Staff") request for additional time to respond to late exhibits presented by Sunrise Water Company ("Sunrise" or "Company"). The late exhibits suggest that the Arizona Corporation Commission ("Commission") authorizes recovery of income tax expense for Limited Liability Companies ("LLC"). The Company contends that since it is a pass-through entity under the Internal Revenue Service ("IRS") Codes, with similar income tax treatment as an LLC, it should be accorded the same treatment.

The primary purpose of Staff's supplemental filing is to rebut the evidence presented by the Company in support of its contention that the Commission allows recovery of income tax expense for LLCs, and by inference, S-Corps. The secondary purpose is to reaffirm Staff's position and the Commission's policy regarding treatment of income tax expense for S-Corps, LLCs or Sole proprietorships.

1 **STAFF ANALYSIS**

2 **Q. What late Exhibits did the Company present in this proceeding?**

3 A. The Company presented a Staff Report and the corresponding Commission decision for
4 Fisher Landing Water and Sewer Works, LLC ("Fisher"); Wickenburg Ranch Water, LLC
5 ("Wickenburg"); and Winchester Water Company, LLC ("Winchester"). For Fisher, the
6 Company referenced Docket No. WS-04047A-01-0713, and the related Decision No.
7 644998. In the case of Wickenburg, the Company cited Docket No. W-03994A-07-0657,
8 and the corresponding Decision No. 70741. Finally, the Company cited the case of
9 Winchester in Docket No. W-04081-02-0957, and Decision No. 65219.

10
11 **Q. Did the aforementioned cases indicate that the Commission had allowed recovery of**
12 **income tax expense for each utility?**

13 A. Yes.

14
15 **Q. Has Staff reviewed the circumstances surrounding the allowance of income tax**
16 **expense in the referenced rate cases?**

17 A. Yes. Staff found that allowance of income tax expense for each utility resulted from an
18 inadvertent omission. As fully discussed below, Staff has corrected these errors in the
19 subsequent rate filings for Fisher and Winchester. In Wickenburg, Staff's recommended
20 income tax expense is not currently being collected from ratepayers.

21
22 **Q. Please explain Staff's conclusion regarding Fisher.**

23 A. In the case of Fisher, Staff erroneously recommended recognition of income tax expense
24 in its current rates. Staff reviewed the Company's application and determined that the
25 Company did not request recovery of income tax expense in the referenced docket. Staff
26 has corrected this oversight in Fisher's pending rate application (Docket No. WS-04047A-

07-0708). In this docket, Fisher did not request recovery of income tax expense, and Staff correctly did not recommend income tax expense for the company.

Q. What are Staff's findings regarding Wickenburg?

A. The late exhibit presented by Sunrise relates to Wickenburg's application for a new Certificate of Convenience and Necessity ("CC&N"). In general, new CC&N applications are based on projected costs that are not subject to the same level of scrutiny as in a rate application. Staff finds that allowance of income tax expense in Wickenburg's CC&N application is a result of oversight on the part of Staff. However, Staff notes that Wickenburg is not currently in operations, and is not collecting income tax expense from ratepayers. Staff anticipates that the Commission will be able to rectify this omission in the future.

Q. Please comment on the Company's assertion regarding Winchester.

A. Again, the Company is correct that the Commission approved recovery of income tax expense for Winchester in Decision No. 65219. However, the Commission in Decision No. 70291 (Docket No. W-04081A-07-0466) corrected this oversight by approving Staff's recommended revenue requirement, which does not include income tax expense. In this most recent proceeding, Winchester did not request recovery of income tax expense.

Q. Did the Company's late exhibits demonstrate that the Commission allows recovery of income tax expense for LLCs?

A. No. To the contrary, the Company's late exhibits show that the Commission inadvertently approved recovery of income tax expense for Fisher, Wickenburg and Winchester. However, the Company's attempt to misconstrue these oversights as the Commission policy is not supported by the most recent proceedings for Fisher and Winchester.

1 **Q. Do the Company's exhibits support its recommendation of including income tax**
2 **expense in this proceeding?**

3 A. No. First, a search of the Commission database (e-docket) shows that Fisher and
4 Winchester did not request recovery of income tax expense in their most recent cases.
5 Second, the Company's affiliate, J. D. Campbell dba West End Water Company, which
6 coincidentally is an S-Corp; did not request recovery of income tax expense in its most
7 recent proceeding (Docket No. W-01157A-06-0004). In addition, the Company failed to
8 reference its affiliate as an example of an S-Corp where the Commission did not grant
9 recovery of income tax expense (Decision No. 68925).

10
11 **Q. Did the Company cite Camp Verde Water System, Inc. as an example of an S-Corp**
12 **where the Commission allowed recovery of income tax expense?**

13 A. Yes. The Company witness, Mr. Ray L. Jones, stated in his rebuttal testimony, at Page 15
14 of 20, that the Commission "...has more recently approved income taxes in the rates of
15 Camp Verde Water System, Inc; an S-Corp."

16
17 **Q. Why did the Commission authorize recovery of income tax expense for Camp Verde**
18 **Water System, Inc.?**

19 A. In Decision No. 60105, the Commission noted at page 9, line 16 as follows:

20
21 *"The Company did not request any income taxes since it is a*
22 *Subchapter S corporation and the Commission has adopted a*
23 *policy of not allowing income taxed for entities which are not*
24 *required to pay income taxes. Similarly, Staff did not recommend*
25 *any income taxes. At the hearing, the Company indicated that*
26 *CoBank would not loan the Company money unless the rates*

1 *approved herein would provide for income taxes that would be*
2 *paid by the individual shareholders.*

3
4 *Under the circumstances presented herein, we are not going to*
5 *adjust the rate of return for income taxes as requested by the*
6 *Company. We are going to allow income taxes in this case at the*
7 *lowest individual/corporate income tax rates of 23.36 percent for*
8 *combined Federal and State income taxes."*

9
10 Further at page 16, Finding of Facts No. 17, the Commission states:

11
12 *"The Company is a Subchapter S corporation and does not pay*
13 *income taxes"*

14
15 **Q. What is the significance of Decision No. 60105 regarding Commission**
16 **policy on allowance of income taxes for S-Corps?**

17 A. As indicated above, the Commission stated its policy of not allowing recovery of income
18 tax expense by non-taxable entities, such as Sunrise. Also, Decision No. 60105
19 categorically stated that Commission approval of income tax expense for Camp Verde was
20 due to the peculiar debt covenant imposed by CoBank for its debt financing. In other
21 words, the Commission exercised its discretion by granting Camp Verde an exception to
22 its stated policy, due to an extraordinary circumstance surrounding its debt financing.

23
24 **Q. Has Staff reviewed recent rate filings by other LLCs?**

25 A. Yes. Staff reviewed previous and current rate filings by the companies shown in Table A
26 below:

1

TABLE A	
COMPANY	DOCKET NO.
Empirita Water Company, LLC	W-03948A-07-0495
Christopher Creek Haven Water	W-20459A-08-0168
Utility System, LLC dba Gardner Water Co.	W-20459A-08-0167
Montezuna Rimrock Water Co LLC	W-04254A-08-0361
Utility System, LLC - Water Division	W-04235A-06-0303
JNJ Enterprises LLC Christopher Creek Haven Division	W-03880A-02-0462
Eagletail Water Company, LLC	W-03936A-04-0840
Naco Water Company, LLC	W-02860A-06-0002 & W-02860A-05-0727

2

3 **Q. Did any of the companies listed above propose recovery of income tax expense in cost**
4 **of service?**

5 A. No. Staff observed that none of the LLCs listed above sought recovery of income taxes in
6 rates.

7

8 **Q. Did Staff recommend income tax expense for any of the referenced entities?**

9 A. No. Consistent with the Commission policy, Staff did not recommend income tax expense
10 in any of the above filings.

11

12 **CONCLUSION**

13 **Q. Based on Staff's analysis, is the Company correct in its assertion that the**
14 **Commission generally approves income taxes for pass-through entities?**

15 A. No. Staff's analysis demonstrates that the Commission has consistently adhered to its
16 policy of not approving income tax expense for pass-through entities. However, Staff
17 notes that the Commission can exercise its discretion based on the facts and circumstances
18 of each filing. The Company's filing does not warrant such exception.

1 **Q** **Is Staff's recommendation regarding treatment of income tax expense consistent**
2 **with Commission policy?**

3 A. Yes. Accordingly, Staff continues to recommend denial of income tax expense for
4 Sunrise.

5

6 **Q.** **Does this conclude your supplemental testimony?**

7 A. Yes.